

Tests for a Monopoly

Three Tests

- Performance
- Rivalry
- Structure

Performance

- How does the firm's actual performance deviate from the competitive norm?

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 - How much does price depart from marginal cost?

Measuring MC is hard

Performance

- How does the firm's actual performance deviate from the competitive norm?
 - How much does price depart from marginal cost?
 - How much does its profit margin exceed that of a comparable competitive industry?

Performance

- Accounting vs. Economic Profits
 - Acme Widgets has a very high debt load. Baker Widgets does not. Acme will have a lower accounting profit margin than Baker. But this does not imply that Baker is monopolistic, only that it has a different capitalization policy.

Performance

- Accounting vs. Economic Profits
- Intangibles
 - Berkley Photo has few intangibles such as patents, etc. Kodak Company has a valuable brand name. Its higher profit margins are attributable to its ownership of a valuable factor of production, not to monopoly power.

Performance

- Accounting vs. Economic Profits
- Intangibles
 - High profit margins are generally a return on historical investments in the pharmaceutical industry. They are evidence of monopoly power from patents and trademarks, permissible under the *Rule of Reason*.

Rivalry

- In a perfectly competitive environment, a firm looks only a price. In a monopolistic environment, price elasticities will matter.
- How do firms change in response to buyer behavior?
- How do firms change behavior in response to changes in a rival's sales and prices?

Elasticity

- Three estimates of the price elasticity of demand for Acme Widgets faces have been published: (a) -0.67, (b) -1.5, and (c) - 10.0.

Elasticity

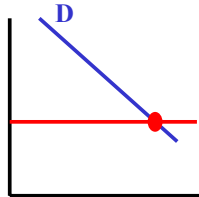
- Three estimates of the price elasticity of demand for Acme Widgets faces have been published: (a) -0.67, (b) -1.5, and (c) - 10.0.
 - The first looks like a screwed up estimate
 - The second might be a monopoly
 - The third looks like a competitive firm.

Rivalry

- Acme Widgets cuts output and is able to raise price.

Rivalry

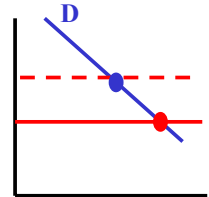
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Rivalry

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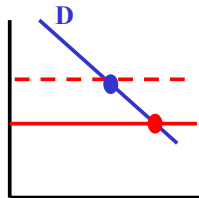


Tests for a Monopoly

Rivalry

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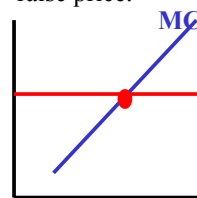
A competitive firm is a price taker.



Tests for a Monopoly

Rivalry

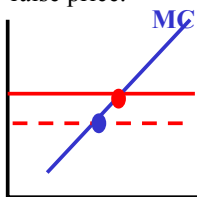
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Rivalry

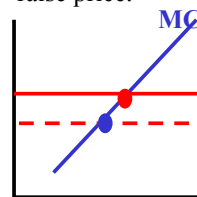
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Tests for a Monopoly

Rivalry

- Acme Widgets cuts output and is able to raise price.



If you see price going up, you will see output rising as well.

Tests for a Monopoly

Rivalry

- The prices of Acme Widgets and Baker Widgets seem to be set like duopolies. While hard to prove this could constitute clear evidence of a cartel.

Summary

While valid tests, they are difficult to prove and use in practice.

Structure

- Does the firm actually have a large market share?
 - A firm with a large market share is considered to be a monopoly: one with a small market share is not.

Measuring Market Share

$$Share = \frac{Sales}{Sales + Substitutes}$$

What is a Substitute

- Substitutes for Coca-Cola
 - Pepsi?

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 - Other Carbonated Beverages?

What is a Substitute

- Substitutes for Coca-Cola
 - Pepsi?
 - Other Carbonated Beverages?
 - Tea?
 - Coffee?
 - Milk?

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 - Water?
- *More to come*

End

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